

**DEPARTMENT OF CORPORATIONS**  
*California's Investment and Financing Authority*



**Preston DuFauchard**  
**California Corporations Commissioner**

IN REPLY REFER TO:  
FILE NO: \_\_\_\_\_

May 7, 2007

Office of the Comptroller of the Currency  
250 E. Street, S.W., Mail Stop 1 – 5  
Washington D.C., 20219

RE: Comments on Proposed Statement on Subprime Mortgage Lending  
Docket Number OCC-2007-0005

To whom it may concern:

As Commissioner for the California Department of Corporations, I write to express support for the focus on subprime borrowers in the March 2, 2007, proposed Supplemental Statement on Subprime Mortgage Lending ("Supplemental Statement"). Beyond that, however, I write to encourage better coordination between federal and state regulators to provide guidelines for mortgage lending.

By way of background, the California Department of Corporations ("Department"), California's Investment and Financing Authority, regulates two types of non-depository lenders authorized to make loans secured by real property, including mortgage loans described to subprime borrowers, as in the Supplemental Statement. The Department regulates 4,418 licensed finance companies operating under the California Finance Lenders Law (Division 9, commencing with Section 22000, of the California Financial Code. In addition, the Department licenses and regulates 448 residential mortgage lenders (known as mortgage bankers) operating under the California Residential Mortgage Lending Act (Division 20, commencing with Section 50000, of the California Financial Code.

In addition, California has been the home state for some of the largest originators in the nonprime mortgage lending market. Companies such as New Century Financial, Accredited Home Lenders, Countrywide, and Ameriquest are based in California, and have originated many loans in the state. Given the experience of the California regulators with regard to these lenders, we offer the following areas of comment as the Office of the Comptroller of the Currency (OCC) moves forward with implementing the Supplemental Statement.

- Securities • Franchises • Off-Exchange Commodities • Investment and Financial Services •
- Independent Escrows • Consumer and Commercial Finance Lending • Residential Mortgage Lending •

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## 1. The Need To Focus On Borrowers

The Supplemental Statement provides an important complement to the Interagency Guidance on Nontraditional Mortgage Products. That Guidance, which California is incorporating into its regulatory structure, provides insight primarily on mitigation of institutional risks. The references to the borrowers tend to be viewed through the institutional lens. In light of the turmoil that has occurred, and may continue, in the subprime mortgage market, we believe the focus the Supplemental Statement places on borrowers is a warranted development.

## 2. Coordination Between Regulators

The National Bureau of Economic Research published a paper in March 2007, which recognizes that U.S. "mortgage markets and capital markets have been integrated."<sup>1</sup> That is to say, the origination, funding, and distribution of mortgage loans form a market channel, not a series of closed transactions. So, while some state-regulated entities may serve a point of origination for such loans, national banks and investment banks provide sources of funding for the loans, and the network for wider sales distribution.

Since the market is functionally integrated, the regulators can be best served by working together to coordinate efforts to implement rules directed at this market.

We encourage the OCC and other federal regulatory agencies to coordinate the implementation of the Supplemental Statement with the Conference of State Bank Supervisors (CSBS) and American Association of Residential Mortgage Regulators (AARMR). I add this point regarding coordination based on empirical evidence of the value of such an approach. The recent turmoil in the subprime mortgage market caused many state-regulated entities to experience liquidity problems, potentially unraveling the ability of these companies to fund loan commitments. As the state regulators became aware of these problems, we devised a strategy to work together to monitor the pipeline of loan applications for each of the larger state-regulated companies. As a result of this effort, borrowers who had negotiated home sales and purchases, and who had received commitments from the lenders, were able to close on their transactions. The scale of the problems faced by the lenders was enormous, but the state regulators made substantial and focused approaches to solve the problems as they pertained to consumers. Accordingly, state regulators can help provide the OCC with meaningful information to assess the need for national standards such as the best practices set forth in the proposed Supplemental Statement.

<sup>1</sup> Gerardi, K., Rosen, H., Willen, P., "Do Households Benefit From Financial Deregulation and Innovation? The Case of the Mortgage Market," (NBER Working Paper 12967, March 2007).

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In closing, the proposed Supplemental Statement recognizes that all borrowers, including borrowers of subprime mortgage loans, expect their lenders to make lawful loans, and to not charge unauthorized fees, impose unreasonable terms, or withhold material facts. Accordingly, the proposed Supplemental Statement will help ensure that mortgage lenders making loans, including non-traditional and subprime loans, will continue to be accountable and transparent in their dealings with borrowers. Moreover, inattentive financial management can also lead to a sudden loss of the financing needed to fulfill loan commitments made to borrowers, as recent experience with some companies has shown. The Supplemental Statement will help guard against these risks through the application of appropriate and supervised lending practices and is consistent with our efforts to protect all borrowers, including borrowers in the subprime market.

Thank you for the opportunity to share these comments with you. Should you have any questions or need additional information, please feel free to contact me at (916) 324-9011.

Very truly yours,

A handwritten signature in blue ink, reading "Preston DuFauchard", with a long horizontal flourish extending to the right.

Preston DuFauchard  
California Corporations Commissioner